FILE COPY

IN THE

Supreme Court of The United States

October Term, 1942

No. 552.

INTERSTATE TRANSIT LINES,
Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

**ON PETITION FOR A WRIT OF CERTIORARI
To The United States Circuit Court of Appeals
For the Eighth Circuit.**

SUPPLEMENTAL BRIEF OF PETITIONER.

Joseph F. Mann,
Darwin P. Kingsley, Jr.,
120 Broadway,
New York City.

Nelson Trottman,
400 W. Madison Street,
Chicago, Illinois.
Attorneys for Petitioner.

McCORMICK AND HENDERSON, INC., CHICAGO

IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 552.

INTERSTATE TRANSIT LINES,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI
To The United States Circuit Court of Appeals
For the Eighth Circuit.

SUPPLEMENTAL BRIEF OF PETITIONER.

In amplification of what appears on page 4 of the petitioner's reply brief herein, and to present fully and fairly the Commissioner's interpretation of this Court's opinion in *Higgins* v. *Smith*, 308 U. S. 473, 60 S. Ct. 355, 84 L. Ed. 406, there are herewith supplied excerpts from the brief of the Commissioner of Internal Revenue in *Commissioner* v. *Moline Properties, Inc.*, Docket No. 10279, Fifth Circuit Court of Appeals, on file with Clerk of that Court.

On pages 18 to 23, inclusive, of said brief appears the following:

"While some of the decisions in the Circuit Courts of Appeals since *Higgins v. Smith* do not entirely con-

form to its doctrinal enunciation, the over-all picture is one of considerable uniformity. In the Tenth Circuit two decisions adhere closely to the doctrine. Another, with a superficial semblance of departure, represents a situation of extraordinary circumstances which in the opinion of the court warranted an exception. Thus, in *Continental Oil Co.* v. *Jones,* 113 F. 2d 557, certiorari denied, 311 U. S. 687, the Tenth Circuit, at the behest of the Government, refused to countenance the validity of certain sales from a parent company to its subsidiaries where the sales were unprecedented in character and amount, no provision was made for predictable payment, and in addition to other circumstances showing that the sales were shams, their purpose was solely to avoid the payment of excise taxes. In *Texas-Empire Pipe Line Co.* v. *Commissioner,* 127 F. 2d 220 (C. C. A. 10th), presenting the converse aspect of the *Higgins* v. *Smith* doctrine, the court denied the taxpayer's contention that the corporate entities of the parent and subsidiary companies should be disregarded and the latter treated as a mere instrumentality of the former. The court found that the subsidiary served two legitimate business purposes, and said (p. 224):

> Having elected to organize the subsidiary to serve legitimate business purposes, the parent must accept the attendant tax disadvantages.

Higgins v. *Smith* and *Burnet* v. *Commonwealth Improvement Co., supra,* were cited in support of this statement. In the earlier case of *Inland Development Co.* v. *Commissioner,* 120 F. 2d 986 (C. C. A. 10th), the court had held that the identity of several subsidiary companies would be disregarded at the behest of the taxpayer-parent corporation. The consequence of treating the subsidiaries as separate corporations would have been to subject the parent to the greater tax imposed upon personal holding companies, by reason of the fact that the bulk of the parent company's income

during the taxable year consisted of an alleged dividend distribution from a subsidiary company. Actually, viewing this specific transaction — the dividend — the subsidiary had no accumulated surplus nor money on hand from which a dividend distribution could have been made. Most important, and this was the ground on which the *Texas-Empire* decision *supra*, distinguished this case, there was no apparent motive or purpose served by the creation of subsidiaries. Whether or not the *Inland* case was correctly decided, in light of the principle of *Higgins* v. *Smith* that the taxpayer may not disavow the form that he chooses for doing business, it is distinguishable from the case *sub judice*, where the corporation was created to serve a definite purpose. Indeed, that purpose, *viz.*, the profitable conclusion of the real estate venture, was so well served that it forms the basis of the controversy here.

United States v. *Brager Building & Land Corp.*, 124 F. 2d 349 (C. C. A. 4th), is distinguishable in at least two respects. Unlike the present corporation, the taxpayer there did not assume the mortgage debt against the property transferred to it. In addition, the court considered (p. 350) that there was—

> little or no distinction in actuality between the corporation and the holders of its stock.

Here, a similar conclusion would fly in the face of the very purpose for which the taxpayer was created. *Cf.* *Sheldon Bldg. Corp.* v. *Commissioner*, 118 F. 2d 835, 836 (C. C. A. 7th), rehearing denied April 15, 1941. It must be recognized that the court in the *Brager* case rejected the generality of the principle laid down in *Higgins* v. *Smith*, *supra*, that when a taxpayer for reasons satisfactory to himself voluntarily chooses to employ a corporation in his operations, he may not disavow it but must accept such tax disadvantages as may result. This principle was stated by the Supreme Court deliberately and without qualification. The

enunciation of the principle was perhaps beyond the necessities of the immediate issue in the case. As such, its very deliberation and lack of qualification achieve even greater significance than otherwise might be the case. For its apparent purpose was a *caveat* against an interpretation of the holding that would lead taxpayers to urge the case as authority in situations where it would be to their advantage to urge nonrecognition of their chosen forms of doing business. The language of the *Brager* case (p. 351) might lead to the supposition that the Government there was affirmatively and arbitrarily taking the stand that a sham arrangement had to be recognized because it was to the advantage of the revenue. While such a stand requires no apology in the light of the express language of *Higgins* v. *Smith*, the court's emphasis was tangential. Actually, the situation was one in which the taxpayer, a deliberately chosen entity, was urging that it was no entity at all. So long as no tax problem arose it would have the world respect its identity. Upon the death of the surviving partner (its sponsor), it would assert its individuality "to avoid complications" (p. 350). But once it became apparent that a tax saving would result by virtue of merging its taxable income with the individual items of its sponsor, it proceeded to disavow itself. The Government simply took the corporation as it found it and as the corporation would have had the entire world, with the exception of the tax collector, find it. It is difficult to perceive anything arbitrary in that position of the Government.

Lyon, Inc., v. *Commissioner*, 127 F. 2d 210, 212-213 (C. C. A. 6th), is not authority against the Commissioner here. It did not involve an attempt by the taxpayer to have the corporate entity disregarded. The question discussed by the court was whether a transaction which could not under the law be a reorganization might, at the option of the Government, be treated as such for the purpose of imposing a tax.

The principles of *Higgins* v. *Smith*, quoted above, have been followed in these cases: *Helvering* v. *Jane*

Holding Corp., 109 F. 2d 933, 943 (C. C. A. 8th), rehearing denied March 16, 1940, certiorari denied, 310 U. S. 653, rehearing denied, 311 U. S. 725; *Mead Corp.* v. *Commissioner*, 116 F. 2d 187 (C. C. A. 3d); *Mehrlust* v. *Higgins*, 112 F. 2d 717 (C. C. A. 2d); *Brown* v. *Commissioner*, 115 F. 2d 337 (C. C. A. 2d); *Watson* v. *Commissioner*, 126 F. 2d 203 (C. C. A. 2d); *Vim Securities Corp.* v. *Commissioner* (C. C. A. 2d), decided July 21, 1942 (1942 C. C. H., par. 9602; *Interstate Transit Lines* v. *Commissioner* (C. C. A. 8th), decided July 31, 1942 (1942 C. C. H., par. 9618). *Cf. Commissioner* v. *Laughton*, 113 F. 2d 103 (C. C. A. 9th).

In *Watson* v. *Commissioner, supra*, the taxpayer sought to deduct the losses of two corporations which he had created and which nominally published two magazines. In general, the corporate entities were disregarded and the taxpayer, who was the sole beneficial owner of the stock, managed the business operations as if he were individually the publisher. All financing was done on his personal credit. He provided the funds needed by the corporations, paid their obligations and endorsed their notes. He never received any evidences of indebtedness from the companies for his expenditures. The court denied the deduction. It held that *Higgins* v. *Smith, supra*, militated against the taxpayer, saying (p. 439):

> Having chosen the corporate form he cannot complain that he is held to it by the taxing officials.

The contention that the corporations were neither formed nor availed of to secure a tax advantage was held to be irrelevant.

Interstate Transit Lines v. *Commissioner, supra*, involved a parent and its subsidiary corporation. The parent claimed that it was entitled to deduct the loss of the subsidiary. The subsidiary agreed to operate busses upon such routes and schedules and under such rules and regulations as the parent should direct. The latter was to make good any deficit of the former,

which in turn was to pay over all its profits to the parent. Both companies had the same officers and directors. While the subsidiary had its own records, they were kept at the parent's office by the parent's employees. The parent collected all the revenues of the subsidiary and paid all its bills. The subsidiary had no separate bank account. A definite purpose was served by the creation of the subsidiary. The court relied on *Higgins* v. *Smith, supra,* to reach the conclusion that the corporate entity of the subsidiary could not be disregarded, nor the tax disadvantage resulting from its organization avoided.

The prior decisions of the Board which are the reliance of the opinion below failed to analyze the problem in the light of the principles of *Higgins* v. *Smith*. We submit that the doctrine of that case and the preponderance of authority require rejection of the taxpayer's attempt to disavow its own existence in order to avoid a tax disadvantage resulting from its creation."

Copy of Attorney General's letter to Clerk of the Circuit Court of Appeals for the Fifth Circuit in *Commissioner* v. *Moline Properties, Inc.*, Docket No. 10279 in that Court, in response to taxpayer's petition for rehearing filed therein November 28, 1942 is as follows:

"SOC" BMB:fs
5-7069

December 7, 1942

Oakley F. Dodd, Clerk
United States Circuit Court of Appeals
for the Fifth Circuit
New Orleans, Louisiana

Re: *Commissioner* v. *Moline Properties, Inc.*
No. 10279

Sir:

A copy of the taxpayer's petition for rehearing, filed on November 28, 1942, has been received. Because the

matters therein stated were fully discussed in the briefs of the parties and in the argument before the Court, and add nothing new to be considered, this office does not propose, unless request should be made by the Court, to file a formal reply.

The substance of the petition appears to be that this Court has unjustifiably reversed a decision of the Board on a question of fact. Actually, however, the decision of this Court was that the Board had erred in its application of legal principles to the facts before it. The taxpayer also complains (Pet. 4) that there is nothing in the record or the Board's findings to show that the form employed for doing business was unreal or a sham. Presumably, the absence of such evidence and such a finding tends to sustain the Commissioner's position. The question here was not whether a given transaction, such as a sale from a stockholder to his corporation, was a reality or a sham, but whether a voluntarily-selected form for carrying on a business could be disavowed when a tax saving might result.

Respectfully,

For the Attorney General,
SAMUEL O. CLARK, JR.,
Assistant Attorney General."

CC: R. H. Eyles,
Seybold Building,
Miami, Florida

Douglas D. Felix,
Congress Building,
Miami, Florida

The Prentice Hall organization, one of the two standard recognized "services" on the subject of taxation, had the following comment in a recent "What's Happening" release (of November 28, 1942):

"DISREGARDING CORPORATE ENTITY

Can the corporate form be disregarded in determining tax consequences of operations of property held

by corporation? Question often arises in connection with "dummy" real estate corporations. Sole stockholder claims he and corporation are one and the same. Hence, he argues, no tax should be imposed on corporation; its income or loss should be treated as his individual income or loss.

BTA has upheld argument in many cases. Recently, Fourth Circuit ruled likewise in a well considered opinion (*U. S.* v. *Brager*, 124 Fed. (2d) 349). More recently, Second and Fifth Circuits have held to the contrary: *Watson* case from 2nd Circuit (124 Fed. (2d) 437), holding sole stockholder could not deduct corporation's operating loss; *Moline* case from 5th Circuit (11/7/42) holding income taxable to corporation and not to its sole stockholder.

Observation 1 Conflict among Circuits indicates possibility that question may be settled soon by Supreme Court. Meanwhile those concerned (both stockholder and corporation) should take appropriate steps to insure refunds in event of favorable decision.

Observation 2 It is settled that the *government* may disregard the corporate entity when used to commit fraud, or for tax evasion purposes (*Higgins* v. *Smith*, 308 U. S. 473)."

While the present application is not a real estate case, the view of law taken herein of the opinion below is the same as that adopted by the Fifth Circuit in its opinion reversing the *Moline Properties, Inc.*, case. The Commissioner relied heavily on the decision below herein and the

Court followed it as an authority. The conflict with the *Brager* opinion, 124 F. (2d) 349, is plain, and appears to have been recognized even by the Commissioner himself.

Respectfully submitted,

JOSEPH F. MANN,
DARWIN P. KINGSLEY, JR.,
120 Broadway,
New York City, New York.

NELSON TROTTMAN,
400 West Madison Street,
Chicago, Illinois,
Attorneys for Petitioner.